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IN THE

Supreme Court of the United States

OCTOBER TERM, 1959

No. 387

AMERICAN TRADING AND PRODUCTION CORPORATION,
Petitioner

v.

RAILROAD COMMISSION OF TEXAS, PHILLIPS PETROLEUM COMPANY, JOSEPH I. O'NEILL, JR., AND MURPHY H. BAXTER, *Respondents*

PETITION FOR A WRIT OF CERTIORARI

To The Court Of Civil Appeals For The Third Supreme Judicial District of Texas At Austin

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PETITION FOR A WRIT OF CERTIORARI

To The Court Of Civil Appeals For The Third Supreme Judicial District of Texas At Austin

Petitioner prays that a writ of certiorari issue to review the judgment of the Court of Civil Appeals for the Third Supreme Judicial District of Texas, entered in the above-entitled case on April 1, 1959. In the alternative, petitioner prays that a writ of certiorari issue and that this case be remanded for consideration of the federal constitutional questions present in the case.

OPINIONS BELOW

The order of the Railroad Commission of Texas, Oil and Gas Division, denying the application of petitioner for permission to develop and protect its gas and oil mineral rights in certain lands by drilling a well thereon is unreported and is printed in Appendix C hereto, p. 28a, *infra*. The judgment of the District Court for

the 53rd Judicial District of Texas setting aside the order of the Railroad Commission, also unreported, is printed in Appendix C at p. 26a, *infra*. The opinion of the Court of Civil Appeals for the Third Supreme Judicial District of Texas, reversing the District Court, is printed in Appendix C, *infra*, at p. 11a, and reported at 323 S.W. 2d 474.

JURISDICTION

The judgment for which review is sought was rendered by the Court of Civil Appeals, Third Supreme Judicial District of Texas, on April 1, 1959. Rehearing was denied April 22, 1959. Application for writ of error in the Supreme Court of Texas was denied on June 17, 1959. A rehearing in that court was requested on June 30, 1959, and denied on July 29, 1959.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

QUESTIONS PRESENTED

Petitioner was the owner of gas and oil rights in two adjoining tracts in Texas. It "farmed-out" its rights to a large gas and oil operator. The operator was obligated to drill a well on each tract. Petitioner retained the right to drill in case the operator failed to do so within a specified time. Petitioner's retained right was a property right under state law. This type of "farm out" arrangement is a widespread practice, often used by ranchers or small property owners who enter into such agreements with operators who are financially able to drill wells and are willing to take the risks. Typically, these operators have or obtain other interests in the same field and are in a position to capture the gas and oil underlying the "farmed out" land through their other wells. This is a basic reason

why the "farm out" agreements obligate the operator to drill a well within a specified time, and preserve the right of the original owner to drill if the "farm out" operator does not do so as specified.

The operator drilled on one tract but failed to do so on the second, and petitioner thus regained its entire interest therein. Before the operator's allotted time had elapsed, however, the Railroad Commission of Texas established Field Rules prescribing minimum acreage for drilling wells. To avoid confiscation of the interest of persons with mineral rights in tracts smaller than the minimum size, the Commission's rules permitted drilling on any such tract if the tract or any interest therein existed under separate ownership prior to the new rules.

The Commission denied petitioner permission to drill on its undrilled tract in spite of the fact that its retained property right in the tract existed prior to the new rules. In effect, the Commission held that its rules did not protect the property interest retained by the original owner in the "farm out" agreements.

The questions presented are:

1. Was the Commission's application of its new well-spacing rules in a way which deprived petitioner of all opportunity to enjoy its valuable pre-existing property right a taking of petitioner's property in violation of the due process clause of the Fourteenth Amendment?

2. Was the Commission's refusal to protect petitioner's pre-existing property right, even though the Commission's rules were worded and conventionally applied to protect all pre-existing property rights, a denial of equal protection in violation of the Fourteenth Amendment?

CONSTITUTIONAL PROVISION, STATUTE AND REGULATIONS INVOLVED

1. Constitution of the United States, Amendment 14, Section 1.

> "nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

2. Vernon's Annotated Civil Statutes, Article 6008, §§ 1, 6, 10, 11, 12, 13, 14, 16.

Printed in Appendix A, p. 1a, infra.

3. Railroad Commission of Texas, Special Order No. 8-36, 924, Adopting Operating Rules for the Azalea (Strawn) Field, Midland County, Texas, Effective November 21, 1957.

Rule 1

Printed in Appendix A, p. 5a, infra.

4. Railroad Commission of Texas, Special Order Dated May 29, 1934, Regarding Application of Rule 37.

Printed in Appendix A, p. 6a, infra.

STATEMENT OF THE CASE

Under the law of Texas, gas and oil and other minerals in place are real property.[1] A gas and oil lease transfers to the lessee a determinable fee in the gas

[1] *Mills* v. *Brown*, — Tex. —, 316 S.W. 2d 720 (Tex. Sup. Ct. 1958); *Sheffield* v. *Hogg*, 124 Tex. 290, 77 S.W. 2d 1021 (Tex. Sup. Ct. 1934). See 24 Am. Jur. 545 (Gas and Oil § 39).

and oil, with all appurtenant rights, including the rights to drill and produce the gas and oil.[2]

These rights are, however, subject to regulations promulgated by the Railroad Commission of Texas.[3] In order to promote the economic development of each field, the Commission establishes the minimum required acreage per well. But to protect persons with mineral interests in small tracts, it is required by state law to permit one well on any tract, however small, if a distinct interest in the tract is owned, prior to the well-spacing rule, by a person who does not have an identical interest in adjoining tracts.[4] In order to achieve a fair allocation between large and small tracts, the Commission also establishes the maximum allowable production per well.[5]

In this case petitioner, American Trading and Production Corporation, was the lessee under gas and oil leases covering the Northwest and Southeast quarters of Section 29 in the Azalea (Strawn) Field, a proven gas and oil field in Midland County, Texas. (R. 2)*

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[2] *Ibid.*

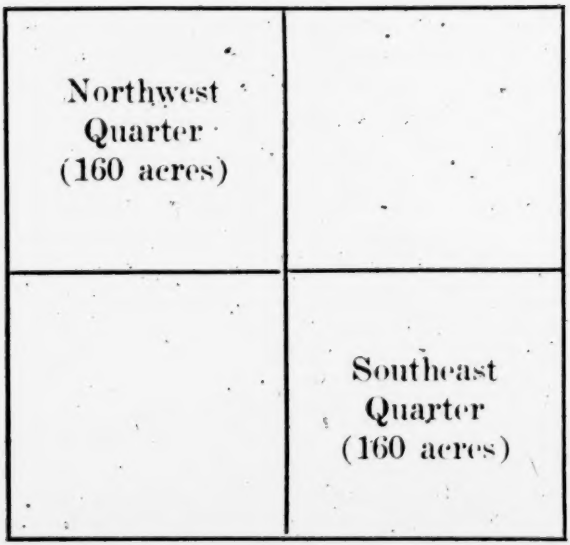
[3] Vernon's Ann. Civ. Stat. Art. 6008, §§ 1-16. Pertinent provisions are printed in Appendix A, *infra*, pp. 1a-5a.

[4] *Railroad Commission of Texas* v. *Humble Oil & Refining Co.*, 151 Tex. 51; 245 S.W. 2d 488 (Tex. Sup. Ct. 1952); *Texas Co.* v. *Railroad Commission of Texas*, 246 S.W. 2d 487 (Tex. Civ. App. 1952).

[5] Vernon's Ann. Civ. Stat. Art. 6008, §§ 12, 13. Appendix A, *infra*, pp. 3a-4a.

* References marked "R" are to the Statement of Facts volume from the District Court, contained in the certified record filed with this Court.

Section 29



American "farmed out" these two tracts to one O'Neill, under an assignment pursuant to which it retained an overriding royalty interest and O'Neill agreed that he would either drill a producing well on each of the two tracts or would forfeit the tract on which such a well was not established to American so that American could drill the well. (R. 3-5) The density of one well for each 160-acre tract complied with the then existing regulations of the Commission.[6] O'Neill drilled a producing well on one tract (the Southeast quarter, not involved here) so that thereafter American had no further rights in that tract other than its overriding royalty. (R. 5) But this did not affect American's rights in the second tract (the

[6] The spacing rule in effect at that time—a statewide rule applicable wherever special rules have not been established for a specific field—permitted a well on each 20 acres.

Northwest quarter), which is in issue in this case. With respect to that tract it was entitled either to have O'Neill drill a well thereon or to drill one itself if O'Neill failed to do so. This was a property right of great value.

In this situation the Commission adopted Special Field Rules for the field in which the Northwest quarter was located.[7] These rules changed the pre-existing spacing requirements by providing for a density of one well for each 640 acres. By their own terms the new rules could not be applied to confiscate or impair any pre-existing interests in tracts less than 640 acres. The rules specifically stated that "in order . . . to prevent confiscation of property" the Commission "will" grant permits for drilling on tracts smaller than the 640-acre size prescribed. This provision was in accordance with decisions of the state courts requiring the Commission to permit a well to be drilled on any tract, regardless of size, if at the time the spacing rule takes effect there is not a complete identity of interest between the owners of that tract and any adjoining tract.[8]

After the rules were promulgated the time allowed O'Neill to drill a well on the second tract expired and thus by operation of law petitioner came into possession of the full leasehold interest in the tract. All the rights of the assignee in this tract under the "farm-out" assignment terminated and all such rights, in-

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[7] Appendix A, *infra*, p. 5a.

[8] See *Railroad Commission of Texas* v. *Humble Oil & Refining Co.*, 151 Tex. 51, 245 S.W. 2d 488 (Tex. Sup. Ct. 1952); *Texas Co.* v. *Railroad Commission of Texas*, 246 S.W. 2d 487 (Tex. Civ. App. 1952).

cluding the right to drill for and possess the minerals, were held by American. On request of American, O'Neill subsequently executed a formal reassignment document (R. 5) so that American could maintain a clear title of record.[9]

American then applied to the Commission for a permit to drill on the Northwest quarter so as to avoid confiscation of this tract. (R. 6) American set forth in its application the fact that, when the new spacing rule was adopted, the tract for which the drilling permit was sought existed as a separate tract, and at the hearing the instruments establishing petitioner's distinctive rights in the Northwest quarter were put into evidence.

The Commission refused to grant petitioner a drilling permit. (R. 6; Appendix C, *infra*, p. 28a.) It held, in effect, that only the temporary rights of the operator, entitled to drill at the time the field rules

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[9] The time schedule of the important events was as follows:

1. Assignment by American to O'Neill	March 21, 1957
2. O'Neill completed well on Southeast quarter of Section 29	August 9, 1957
3. New Field Rules took effect (actually established December 19, 1957)	November 21, 1957
4. Expiration of time allotted to O'Neill for drilling new well	January 7, 1958 [Note]
5. Formal reassignment of undrilled Northwest quarter to American by O'Neill	January 22, 1958

[Note: This period had been extended one month by agreement. Otherwise it would have ended December 7, 1957. This fact is not important, however, since the new field rules took effect on November 21, 1957.]

took effect, need be preserved or considered. In its decision the Commission made no mention of the pre-existing rights reserved by the petitioner in its farm-out assignment. The stated reasons for its decision were that there was an identity of interest throughout both tracts when the field rules took effect, that American reacquired its interest in the Northwest quarter after the new rules, and that therefore to permit American to drill would circumvent the field rules.[10] The Commission assumed that American's rights arose solely from the formal reassignment by O'Neill. But, as acknowledged by the Court of Civil Appeals,[11] it is clear under state law that petitioner regained the possessory estate not by the reassignment but by virtue of its retained interest, which predated the field rules.

This decision by the Commission left the petitioner with a bare legal interest in this tract of land without any right to utilize it by drilling for and producing gas and oil. The Commission decision did not, however, require a reduction in the amount of production, or the rate of production, from the Azalea (Strawn) Field. Under the Texas regulatory system the total monthly allowable production from the field simply continued to be apportioned among the other well owners in the field.[12]

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[10] The Commission cited a general rule that small tracts subdivided subsequent to a spacing rule will not be considered as requiring a well in order to avoid confiscation. (The rule is printed in Appendix A, p. 6a, *infra*.)

The petitioner had advanced the danger of "waste" as an alternative reason for granting the permit, but the decision of the Commission on that issue, also adverse to petitioner, is not at issue in this case.

[11] 323 S.W. 2d 479, 480; Appendix C, *infra*, pp. 18a, 20a.

[12] Vernon's Ann. Civ. Stat. Art. 6008, § 12. See 1A Summers on Oil and Gas 89, 90.

American then petitioned the District Court for the 53rd Judicial District of Texas to set aside the Commission's order. It asserted that the Northwest quarter was entitled to a well, under the above-cited authorities,[13] in order to permit the owner a fair chance to share in the recovery of minerals from the common reservoir under his land. Phillips Petroleum Company, O'Neill, and Baxter, all respondents herein, intervened as defendants in the District Court because of their interest in the mineral rights on neighboring tracts. The District Court found that the facts alleged by American were true—namely, that the Northwest quarter was in existence as a separate tract at the time of the adoption of the new field rules by reason of American's retained interest therein. Accordingly, on September 24, 1958, it entered judgment for American enjoining the Railroad Commission from further refusing to permit American to drill and produce its well. (Appendix C, *infra* p. 26a.) The Railroad Commission then issued a drilling permit, and American proceeded to drill a well on the Northwest quarter from which it secured valuable commercial production of gas and oil.

The Commission and the intervening operators of wells on adjoining tracts (including O'Neill) appealed to the Court of Civil Appeals for the Third Supreme Judicial District of Texas. The Court of Civil Appeals reversed the decision of the District Court on April 1, 1959. (Appendix C, pp. 11a-25a *infra*). The reason stated by the Court for its decision was that:

> "It is our opinion that O'Neill was vested with the title to the leasehold interests covering the SE 4

[13] Note 8, *supra*.

of Section 29 and the NW 4 of Section 29 when, on January 22, 1958, he conveyed by way of reassignment the leasehold interest covering the NW 4 of Section 29 to American. This assignment constituted an illegal subdivision under the density rule then applicable to the area in which the land was located."[14]

By saying that "O'Neill was vested with the title to the leasehold interest" the Court did not mean that American did not also have a property interest in the Northwest quarter. Elsewhere in the opinion the Court stated that "O'Neill was vested with a title which was subject to forfeiture upon condition." (323 S.W. 2d at 480; Appendix C, p. 20a, *infra*). The Court ignored American's interest, however, and entered a ruling which destroys the property interests of American and the other owners of the tract by permitting adjoining operators, including the intervenors, to produce the gas and oil which belongs to American and the other owners.

American filed a motion for rehearing (Appendix B, *infra*, p. 7a), in which it asserted specifically that the denial of a permit to drill constituted a taking of American's pre-existing property rights in violation of the due process and equal protection provisions of the Federal Constitution.[15] The motion for rehearing was denied.

[14] 323 S.W. 2d at 479; Appendix C, p. 17a, *infra*. American had also advanced an independent ground to sustain the decision of the District Court which was decided adversely to it by the Court of Civil Appeals. This alternative ground is not an issue in this case.

[15] This assertion of the constitutional questions was timely under state law. See 3B Tex. Jur. 261, Appeal and Error § 859 (Now 4 Tex. Jur. 2d 234, § 740); *Sid Westheimer Co.* v. *Piner*, 263 S.W. 578.

On May 22, 1959, American applied to the Supreme Court of Texas for a writ of error (Appendix B, *infra*, p. 9a). The application also asserted specifically that denial of the permit constituted a confiscation of petitioner's property in violation of the due process and equal protection clauses of the Federal Constitution. The application was refused on June 17, 1959. American filed a motion for rehearing on June 30, 1959, again specifically asserting violation of the Federal Constitution's due process and equal protection clauses. This was denied on July 29, 1959.

REASONS FOR GRANTING THE WRIT

The Court of Civil Appeals has made a decision substantially impairing the rights of owners of small tracts in undeveloped fields who lease or "farm out" their tracts to have them drilled and developed. The effect of the decision is that small farmers or ranchers as well as others who enter into "farm-out" agreements with established operators may find, when the field is "proven", that their right to share in the bounty of their gas and oil is substantially forfeited and destroyed and that their gas and oil is being drained off by others. This important decision was made without adequate or indeed any consideration of its damaging effect on large numbers of property owners and without discussion of the constitutional questions involved. It is clearly not in accord with the applicable decisions of this Court.

1. Importance of the Question

This case involves retained property interests in gas and oil which play and have historically played a vital role in gas and oil transactions. Such interests are presently held by many persons who have placed

reliance thereon in the belief that they are as fully protected against confiscation as are other real property interests. The effect of the state court's decision is to deprive these interests of very fundamental protections, thereby upsetting the heavy reliance placed on them, impairing their utility in future transactions, and depriving many landowners and lessees of the means to secure development and protection of their gas and oil property rights. The decision removes these retained property interests from the constitutional protection against confiscation and denies them equal protection with other mineral property rights.[16]

a. Why the interests are created. The owner of a mineral fee very frequently finds it necessary or expedient to arrange for another person to conduct exploration and drilling on the owner's estate. The owner—often a farmer, rancher or other person with no experience in mineral development—may find he does not have the necessary expert knowledge or risk capital to attempt drilling on his own land. Thus, ordinarily he executes a mineral lease. Such leases, under Texas law, pass to the lessee a qualified fee interest in the minerals, leaving the original owner with a reversionary right which will return the fee to him on the lessee's failure to develop the minerals in a proper and timely fashion.

In turn, the lessee may "farm out" portions of the mineral estate because he cannot or does not wish to take the risks involved in drilling in the portions he assigns. This is a sublease. The sublessor commonly retains an interest which insures that the fee will return to him in case the sublessee does not develop the

[16] A discussion of the conflict between the lower court's decision and applicable decisions of this Court appears in section 2, *infra*.

property in a proper and timely fashion. This protects not only his interest in the gas and oil but also that of the original owner.

The interest retained by the original owner who leases minerals is the same as that retained by the lessee who subleases under a "farm-out" assignment. It has universally been held in Texas to be a real property interest.[17]

b. Importance of the interests. These retained interests are of extreme importance to persons attempting by lease or "farm out" to secure development of their oil properties, because they constitute the sole security against a most dreaded possibility—failure of the lessee (or sublessee) to develop mineral reosurces which are being developed by neighboring owners.[17a]

An original owner of rights in a reservoir of minerals wishes to have it developed at least as fast as his neighbors, so that he will not find a good part of the reservoir drained when he finally drills his well and begins to share in the allocated withdrawals from the reservoir. His retained interest protects him against undue delay by his lessee.

Similarly, the lessee who "farms out" a portion of his mineral estate wishes to secure development thereon before significant drainage occurs. And, in addition, he must assure himself of development in due time or he may find that all of his interest is forfeited to the original lessor by virtue of the lessor's retained

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[17] *E.g. Sheffield* v. *Hogg*, 124 Tex. 290, 77 S.W. 2d 1021 (Tex. Sup. Ct. 1934); *James* v. *Dalhart*, 254 S.W. 2d 826 (Tex. Civ. App. 1952); *Walts* v. *City of Houston*, 196 S.W. 2d 553 (Tex. Civ. App. 1946); *Caruthers* v. *Leonard*, 254 S.W. 779 (Tex. Com. App. 1923); *Perry* v. *Smith*, 231 S.W. 340 (Tex. Com. App. 1921). See 24 Am. Jur. 545 (Gas and Oil, § 39).

[17a] See 2 Summers on Oil and Gas 317 (§ 303)

right. The lessee's retained interest in the "farmed out" properties is designed to protect him against this double peril.

c. Widespread use of the interests. Leases and "farm-outs" (subleases) are transactions essential to the economic development of gas and oil resources, in that they permit the ready transfer of mineral estates to parties capable of and interested in developing them. And the retained interests created in these transactions constitute the basic insurance that the purpose of the transactions will be carried out. Essentially, the retained interest represents a right reserved by a transferor of mineral property to secure timely development of his property by one means or another. It gives him the right to drill in case his transferee defaults.

For these important commercial reasons, a retained interest is found in virtually every mineral lease and in a great proportion of mineral subleases or "farm-outs".

d. Impact of the court's ruling. The ruling of the Court of Civil Appeals in the present case cuts a broad hole in these important and widely held property rights. It deprives the owners of such rights of all protection against serious dangers from which the owners were previously secure.

In determining whether American had an interest in the Northwest quarter prior to the new field rules, the Court ignored American's carefully retained property interest. It paid attention to O'Neill's rights, acquired in the "farm-out" assignment from American, but neglected entirely American's interest, which

had been reserved in the same assignment. The evident effect of the Court's decision is to distinguish between the operator's mineral interest and the petitioner's retained interest, treating the latter as though it were not to be considered a property interest at all.

This neglect of the retained interest means, most immediately, that these rights are not entitled to protection against subsequently established spacing rules. Thus the precise deprivation presented by this case can recur whenever new field rules take effect after execution of a lease or farm-out assignment. The party having an obligation to drill, on peril of forfeiting his interest, can drill on one portion and refrain from developing the remaining sectors on which he has an obligation to drill. Those sectors will revert to the holder of the retained interest, but he—just like petitioner in the present case—will be barred from drilling thereon. Meanwhile the assignee, though no longer having the obligation to drill, will be able to withdraw, through his well, the minerals lying under the reverted land. It is interesting to note that this is precisely the position of the assignee, O'Neill, in this case, and that he intervened in the proceedings below to aid in securing this advantage to himself.

More fundamentally, the principle of this case can lead to other serious losses to the holders of retained interests. There is no reason whatever to expect, under the state court's decision, that interests of this sort will not be considered—in other contexts as well as the present one—as something less than interests in real property. For example, holders of such interests can find themselves not entitled to participate in proceedings before the Railroad Commission or to appeal to

the courts with respect to regulatory orders affecting the lands in which the hold an interest. Thus the holders of retained interests will be deprived of procedural and substantive rights to which holders of real property rights are entitled.

The Court of Civil Appeals ignored the fact that the relationship between American and O'Neill was governed by American's retained property right. It treated the parties as though they were simply two parties to a contract who had agreed to develop certain lands on a 160-acre basis. By doing this, it makes their interests more readily subject to alteration by regulatory action, but in the process it transforms and drastically impairs the property right which had in fact been established prior to the spacing rule and was retained and in existence when the spacing rule was imposed. It thus demotes literally thousands of carefully established retained interests—*always previously considered interests in land under state law*—to the status of mere contractual rights subject to defeasance in many ways previously considered impossible.

Whether or not the court's revolutionary decision was correct as a matter of state law is not of course a matter of concern here. The above facts clearly demonstrate, however, the importance of determining whether the decision can stand under the Federal Constitution.[18]

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[18] "The protection of private property in the 5th Amendment presupposes that it is wanted for public use, but provides that it shall not be taken for such use without compensation. A similar assumption is made in the decisions upon the 14th Amendment. Hairston v. Danville & W.R. Co., 208 U.S. 598, 605. When this seemingly absolute protection is found to be qualified by the police

2. Conflict With Applicable Decisions of This Court

a. Due process. Under the circumstances described above, the Commission's action in refusing American a permit to drill on the 160-acre tract in which it held a valuable interest prior to and at the time of the spacing rule constitutes a taking of American's property without compensation, in violation of the Due Process clause of the Fourteenth Amendment. The decision of the Court of Civil Appeals upholding the Commission represents a complete (if perhaps unwitting) repudiation of the leading decisions of this Court in *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393 (1922) and *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. 55 (1937). It is also contrary to other decisions of this Court dealing with the taking of private property by sovereign regulatory authority.

Petitioner does not, of course, contend that the State of Texas lacks authority to regulate mineral development, in the interest of conservation and protection of the correlative rights of all landowners. See *Cities Service Gas Co.* v. *Peerless Oil and Gas Co.*, 340 U.S. 179 (1950); *Champlin Refining Co.* v. *Corporation Commission*, 286 U.S. 210 (1932); *Ohio Oil Co.* v. *Indiana*, 177 U.S. 190 (1900). Nor does petitioner raise any question as to the validity of the Commission well-spacing regulation. See *Railroad Commission* v. *Rowan & Nichols Oil Co.*, 310 U.S. 573 (1940), 311 U.S. 570 (1941).

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power, the natural tendency of human nature is to extend the qualification more and more until at last private property disappears. But that cannot be accomplished in this way under the Constitution of the United States." Holmes, J. in *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393, 415 (1922).

Petitioner challenges only the Commission's particular application of its well-spacing rules so as effectively to deprive petitioner of its entire retained property right in the tract here in question. The Commission's action transcends the minimal constitutional limits on state regulatory schemes of this sort.

First, the Commission's action does not simply *restrict* petitioner's enjoyment of its mineral estate; instead it deprives petitioner of its entire mineral estate by precluding petitioner from all production while other well owners proceed to drain the reservoir.

In this respect the action of the Commission clearly conflicts with the decision of this Court in *Pennsylvania Coal Co.* v. *Mahon*, 260 U.S. 393 (1922), a decision which constitutes the cornerstone for much of the modern law on the powers of governmental regulatory authority to impair property interests without compensation. In that case, the coal company conveyed surface rights in a tract it owned, retaining the mineral rights. Later the State enacted a statute prohibiting the removal of coal in such a way as to cause subsidence of inhabited dwellings. In a suit by the grantee of the surface rights, who inhabited a house thereon, the state court enjoined the coal company from removing coal underneath the house. Thus, though the statute was on its face a simple regulatory enactment, it was applied in a way which clearly destroyed mineral property rights predating the statute. This Court held such an application of the statute to be a violation of the due process clause. Speaking through Justice Holmes, it said:

> "As long recognized, some values are enjoyed under an implied limitation, and must yield to the police power. But obviously the implied limita-

tion must have its limits or the contract and due process clauses are gone. One fact for consideration in determining such limits is the extent of the diminution. When it reaches a certain magnitude, in most if not all cases there must be an exercise of eminent domain and compensation to sustain the act.

* * *

"It is our opinion that the act cannot be sustained as an exercise of the police power, so far as it affects the mining of coal under streets or cities in places where the right to mine such coal has been reserved. As said in a Pennsylvania case, 'For practical purposes, the right to coal consists in the right to mine it.'

* * *

"The general rule, at least, is that while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking." 260 U.S. at pp. 413-15.

The early cases approving the authority of the States to regulate production of gas and oil set forth similar ultimate limits on the authority of the States. Thus in *Ohio Oil Company* v. *Indiana*, 177 U.S. 190 (1900), the Court noted:

"As to gas and oil the surface proprietors within the gas field all have the right to reduce to possession the gas and oil beneath. They could not be absolutely deprived of this right without the taking of private property. But there is a co-equal right in them all to take from a common source of supply the two substances which in the nature of things are united, though separate." 177 U.S. at pp. 209-10.

The principle of the *Pennsylvania Coal* case has continued to guide the Court through many years. Thus

in the recent decision in *United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (1958), the Court said at p. 168:

> "[In passing on questions of 'taking'] we have recognized that action in the form of regulation can so diminish the value of property as to constitute a taking. *United States* v. *Kansas City Life Ins. Co.*, 339 U.S. 799, 70 S. Ct. 885; *United States* v. *Causby*, 328 U.S. 256 . . ."

As in the *Pennsylvania Coal* case, the present action of the Texas Commission deprives petitioner of *all* of its carefully reserved rights to the minerals in the Northwest quarter. It did not simply *limit* petitioner's enjoyment of its mineral rights.

In fact, the present case is even more objectionable than the *Pennsylvania Coal* case. It was possible in that case—as pointed out by Mr. Justice Brandeis in his dissenting opinion—to view the state's actions as (a) simply a limitation of sub-surface rights for the benefit of more socially important surface rights on the same property, and (b) a temporary limitation rather than a permanent one. No such charitable views of the state's action in the present case are possible.[19]

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[19] Mr. Justice Brandeis asserted that the subsurface owner should not gain greater rights simply because his interest has been severed from the surface rights. Moreover, Brandeis attached importance to the fact that the subsurface owner might eventually have an opportunity to remove the coal when the use of the surface for a habitation was abandoned. In the case at bar, the development of subsurface minerals is not inconsistent with surface uses and is clearly the most important utilization of the land here in question. Elimination of the right to drill amounts to a deprivation of the large part of the value. Moreover—and most important—the deprivation of a *present* right to remove the gas and oil unques-

Second, the Commission's action in absolutely depriving petitioner of all opportunity to enjoy its mineral rights serves no regulatory purpose whatever.[20]

a. It does not prevent waste, inasmuch as it does not require a reduction in the total amount of gas and oil withdrawn from the field or even a reduction in the *rate* of withdrawal. Under the Texas system of regulation, the Commission determines monthly the total amount of minerals which may be withdrawn from a given field. It then apportions this amount among whatever wells are operating in the field at that time.[21] Thus the closing of one well does not require a reduction in the output. The closed well's allowable monthly production may simply be allocated among remaining wells.

b. Nor can it be justified as a means for protecting neighboring owners of gas and oil from disproportionate withdrawals from the common reservoir by petitioner. The Commisson has authority to reduce the amount of gas and oil taken from a small tract in order to prevent the holder thereof from removing an unfair

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tionably constitutes a *permanent* deprivation of the minerals, because neighboring well owners can continue to drain the gas and oil from underneath petitioner's tract. Thus, unlike the case where coal was concerned, it is not possible to look at this deprivation as one which might turn out to be only temporary.

[20] The Commission's statutory charter provides that it shall "prorate and regulate . . . production for the protection of public and private interests: (a) In the prevention of waste as 'waste' is defined herein; (b) In the adjustment of correlative rights and opportunities of each owner of gas in a common reservoir to produce and use or sell such gas as permitted in this Article." See Vernon's Ann. Civ. Stat., Art. 6008, § 10, printed in Appendix A at p. 2a, *infra*.

[21] Vernon's Ann. Civ. Stat., Art. 6008, § 12, printed in Appendix A, *infra*, p. 3a. See 1A Summers on Oil and Gas § 97.

portion of the underlying minerals. It is required to apportion the monthly production of the field among the wells in the field according (among other factors) to the extent of the mineral acreage owned by the various producers.[22] Such an alternative being available to the Commission, there is not even a color of regulatory justification for its refusal to permit petitioner any production whatever.

The lower court's decision conflicts in this respect with the decision of this Court in *Thompson* v. *Consolidated Gas Utilities Corp.*, 300 U.S. 55 (1937). In that case it was clear from the record, as it is here, that the contested order of the Railroad Commission of Texas could not serve either to prevent waste or to protect the correlative rights of the various owners of minerals in the common reservoir. This court unanimously held the order a violation of the Due Process Clause. The Court's opinion, by Mr. Justice Brandeis, stated that "our law reports present no more clear instance of the taking of one man's property and giving it to another."[23]

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[22] Vernon's Ann. Civ. Stat., Art. 6008, § 13, printed in Appendix A at p. 4a, *infra*. 1A Summers on Oil and Gas 90 (§ 97).

[23] 300 U.S. at pp. 79-80. The *Thompson* case concerned these facts: As a conservation measure, owners of gas wells were prohibited from producing if they had no market for the gas removed. All well owners had equal opportunity to find a market and thereby to produce. The complaining party had found a market and constructed pipeline facilities to transport his gas to it. Production from his wells of the quantities needed to serve his market could not cause drainage from the land of others. Yet he was required to purchase gas on a pro-rata basis from other well owners who had not found a market. He was thus required to share his expensively acquired market and transportation facilities with others who had an equal opportunity to market and produce but had not done so. The Commission's order served no purpose whatever in preventing waste or preventing disproportionate withdrawals by one mineral owner.

In both the *Pennsylvania Coal* and *Thompson* cases the state action held to be invalid operated to the particular advantage of other private property owners—to the precise extent it impaired the property of the complaining party. Thus in the *Pennsylvania Coal* case the surface owner was in effect given a valuable subsurface right for which he had not paid, and in the *Thompson* case the other well owners were given a portion of Consolidated's market and pipeline. In the present case, the other private owners of mineral interests in the Azalea (Strawn) reservoir are similarly greatly benefited at petitioner's expense. The state's action, depriving petitioner of all opportunity to remove gas and oil, simply gives them extra production exactly equal to the amount petitioner would withdraw if its well were open.[24]

This Court has not attempted to formulate general rules distinguishing cases of "taking" from cases of "regulation." In *United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (1958), it stated:

> "Traditionally, we have treated the issue as to whether a particular governmental restriction amounted to a constitutional taking as being a question properly turning upon the particular circumstances of each case. See *Pennsylvania Coal Co.* v. *Mahon* . . ." (357 U.S. at 168)

There is not the least difficulty, however, in finding that the present case falls within the category of those

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[24] In *International Paper Co.* v. *United States*, 282 U.S. 399 (1931), this Court was faced with a similar situation. International, owner of certain water rights, had seen them taken away by a wartime government order which permitted another private party to use them. Even though there was considerably greater public necessity for the order than in the present case, the Court held this a taking which required compensation under the Fifth Amendment.

in which an unlawful taking was found to have occurred. The diminution of the value of petitioner's property here is complete and not just partial. Moreover, in contrast to numerous cases in which an unlawful taking was held not to exist, there is no suggestion that the taking herein is necessary or appropriate for a public purpose. *See Miller* v. *Schoene*, 276 U.S. 272 (1928); *Block* v. *Hirsch*, 256 U.S. 135 (1921); *United States* v. *Central Eureka Mining Co.*, 357 U.S. 155 (1958). If American had possessed the present right to drill a well on the tract at the time the new Field Rules were adopted, there would have been no contention that "conservation" required destruction of this right. The only difference in this case is that at the moment the Field Rules were adopted the drilling right was conditionally entrusted to another, subject to an eventuality which quickly happened, namely, a revesting of this right in American a few weeks after the new Field Rules were adopted. There is no claim and there can be no claim that the state's conservation program requires or justifies a destruction of American's right in these circumstances. Finally, the State's action had the effect of transferring to other private parties the valuable property taken away from petitioner. There can be no question that the decision of the Texas Court of Civil Appeals, rendered without any consideration of the due process problem, is contrary to the *Pennsylvania Coal* and *Thompson* cases and to the principles established in the numerous other decisions of this Court concerned with takings of private property.

b. Equal protection. The Commission's action also offends the equal protection clause of the Fourteenth Amendment in two different respects, described below. Thus, even if the due process limits discussed above

were not applicable in this case, the Commission's action would be invalid because it did not afford American the protection which the Commission affords others in substantially the same position.

(1) The Commission applied its own rules to American in a manner which arbitrarily denied American the protection which was afforded other property owners both by the terms of the rules and by the Commission's normal applications thereof. The rules speak in terms of protecting the interests of *all* property owners who held their property prior to the adoption of the new well-spacing requirements in an area.[25] The rules make no distinction between owners of retained rights of the sort possessed by petitioner, on the one hand, and owner of other kinds of property rights, on the other hand.

The established practice of the Commission is to permit the drilling of a well on a tract containing less than the prescribed acreage in any case where the failure to grant such a permit would cause the owner of even the smallest fraction of the gas and oil in a tract to be deprived of equal opportunity with adjoining mineral owners to recover the gas and oil beneath the tract. Our research discloses that this practice of the Commission has been the subject of reported litigation in only two cases.[26] In both, the

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[25] Rule 1 of the new Field Rules for the Azalea (Strawn) field provides that "the Commission will, in order . . . to prevent the confiscation of property, grant exceptions to permit drilling within shorter distances than herein prescribed. . . ." (Appendix A, p. 5a, *infra*.)

[26] *Railroad Commission of Texas* v. *Humble Oil & Refining Co.*, 151 Tex. 51, 245 S.W. 2d 488 (Tex. Sup. Ct. 1952); *Texas Co.* v. *Railroad Commission of Texas*, 246 S.W. 2d 487 (Tex. Civ. App. 1952).

Texas courts required the Commission to grant the permits even though there was complete identity of ownership, as to everything except a very small fraction of the royalty interest, between the tract on which the well was sought to be drilled and an adjoining tract on which a well existed.

In view of the wording of the Commission's rules and its standard practice in administering the rules, the refusal to protect American's substantial and important property interest solely because, at the time the new rules took effect, O'Neill rather than American had the *present* right to drill, constitutes a denial of equal protection. See *Smith* v. *Cahoon*, 283 U.S. 553 (1931); *Cumberland Coal Co.* v. *Board of Revision*, 284 U.S. 23 (1931); *Morey* v. *Doud*, 354 U.S. 457 (1957).

(2) Even if the rules contained an explicit distinction between holders of retained property interests such as petitioner's, on the one hand, and holders of other types of interests on the other, such a distinction would be insupportable as a constitutional matter. There is no reasonable basis for thus differentiating between owners of substantial mineral interests.[27]

THE ALTERNATIVE DISPOSITION

Petitioner suggests that an appropriate form of relief in this case, as an alternative to reviewing the decision of the State Court on the merits, may be the issuance of a writ of certiorari followed by a remand to the lower court for reconsideration of the constitutional questions in this case, and, in its discretion,

[27] See cases cited in the preceding paragraph.

of the questions of state law in the light of the constitutional problems presented.[28]

It is not clear that the court below meant to rule that a retained property interest in gas and oil, created before the Field Rules, need not be protected. On the one hand its opinion acknowledges that the petitioner had a property interest in the minerals on the tract involved prior to the Field Rules.[29] The opinion renders that interest worthless in spite of its priority. The decision therefore will no doubt stand in Texas as authority for the proposition that these important retained property rights are not protected against the confiscatory application of a subsequent field order, even though other interests are thus protected. On the other hand the opinion of the court below indicates that it did not adequately consider the resulting conflict between its holding and the applicable decisions of this Court.

It is uncertain, therefore, that if the lower court should again have an opportunity to consider the constitutional issues, it would persist in the proposition

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[28] A further alternative disposition would be to grant certiorari and then allow a continuance to enable petitioner itself to apply to the State Court for such reconsideration. See *Loftus* v. *Illinois*, 334 U.S. 804, 805 (1948); *Herb* v. *Pitcairn*, 324 U.S. 117 (1945).

[29] The Court said "We construe the farm-out agreement as vesting in O'Neill title to the leasehold estates assigned to him on completion of the first well subject to divestment upon non-performance of the stated conditions (323 S.W. 2d at 479; Appendix C, *infra*, p. 18a). It also said "This is a practical construction of the agreement by the parties and clearly connotes that O'Neill was vested with a title which was subject to forfeiture upon condition." (323 S.W. 2d at 480; Appendix C, *infra*, p. 20a.)

for which its decision stands, namely, that a retained property interest created before the field order may be confiscated by the new spacing rules. It is difficult for us to believe that the state courts, if required to reconsider the constitutional implications, would not protect such widely used and important interests when they preexist new field rules. There is a substantial possibility that the constitutional question now present in the case would be eliminated by a remand and a further decision.

This Court has previously remanded cases raising a federal constitutional question when it appeared that the state courts might have dealt differently with questions of state law if they had given proper consideration to the constitutional question present. See *Williams* v. *Georgia*, 349 U.S. 375 (1955); *Patterson* v. *Alabama*, 294 U.S. 600, (1935).[30]

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari to the Court of Civil Appeals for the Third Supreme Judicial District of Texas should be granted and the case either reviewed by this Court or

[30] Cf. also *Minnesota* v. *National Tea Co.*, 309 U.S. 551 (1940); *Naim* v. *Naim*, 350 U.S. 891 (1955); *Loftus* v. *Illinois*, 334 U.S. 804, 805 (1948); *Herb* v. *Pitcairn*, 324 U.S. 117 (1945).

remanded to the Court of Civil Appeals for consideration of the constitutional questions present in the case.

Respectfully submitted,

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